Philippine Institute
for Development Studies

Policy Notes

January 1997 No. 9701

Developing a Framework for Agroindustrial Restructuring of the Philippine Economy for International Competitiveness*

Ponciano S. Intal, Jr.

This brief Note presents a framework for agroindustrial restructuring for international competitiveness of the Philippine economy. The Note situates the agroindustrial restructuring in the country in the context of the ongoing industrial restructuring and shifts in comparative advantage in the Asia Pacific region. In general, agroindustrial restructuring in the Philippines necessitates the transformation of the economy's production sectors from low to higher value added activities. It requires a policy and institutional environment that would induce industries to become cost efficient and internationally competitive.

International competitiveness is a multidimensional and imprecise concept. Nevertheless, a pragmatic definition is the one provided by the U.S. President's Commission on Industrial Competitiveness: the ability of a country to "produce goods and services that meet the test of international markets while simultaneously maintaining and expanding the real income of its citizens" (as quoted in Ostry 1991). At the firm or industry level, international competitiveness is determined by the constellation of pricing, quality of product, timeliness of delivery, design and market positioning. Ability to export depends on the ability of the country's firms "to design, produce and market a comparable product more efficiently than their international competitors and/or ability to provide unique and

*This is culled from Chapters 1 and 2 of a report entitled "Integrative Report on the Agroindustrial Restructuring and Competitiveness Program of the Philippines" submitted by the author to the National Economic and Development Authority (NEDA) in March 1996.

PIDS Policy Notes are observations/analyses written by PIDS researchers on certain policy issues. The treatise is wholistic in approach, and like the PIDS Executive Memo, it aims to provide useful inputs for decisionmaking.

The author is President of the Institute. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

superior value to the international buyers in terms of product quality, special features, or after sales service" (Porter 1990, p. 37).

For the whole economy, improved international competitiveness means that a wider segment of the economy is able to generate private and social returns from exports and efficient import substitution (i.e., without undue protection)—in other words, enhanced and widened areas of comparative advantage. International competitiveness implies ability to export, efficient use of resources and rising productivity.

International competitiveness encompasses both the static and dynamic efficiencies of a national economy. Static efficiency deals with the basic question of whether or not the country ensures a high level of output and consumption for its citizens given the resources available to the country at a particular point in time. Dynamic efficiency calls for rising domestic saving rate and efficient allocation of those savings to the most productive investments in order to ensure high growth of the national income, growing employment and rising welfare of its workers over time (Sachs 1995). Thus, the level and rate of increase of the productivity of the country's resources vis-a-vis those of other countries are central determinants of the country's extent of and change in international competitiveness.

For the Philippines, where unemployment and underemployment are serious problems and the arable land-to-man ratio is less favorable than most other Asia Pacific economies, improving the country's international competitiveness entails

▲ lowering the country's labor cost in efficiency terms, and

▲ improving the country's agricultural productivity relative to its competitor countries.

Lowering labor cost in efficiency terms requires raising labor productivity relative to competitor countries together with more realistic wage and exchange rates. Improving labor productivity necessitates better resource allocation, more reliable infrastructure as well as technological, organizational, institutional and skills improvement.

A "strategic trade and agroindustrial policy" for international competitiveness calls for economic policy that is geared to a better positioning of the Philippines in the world market, taking full advantage of the country's current comparative advantage while at the same time building the foundations for future areas of comparative advantage (Intal 1987). Thus, improving the international competitiveness and enhancing the comparative advantage of the country's agroindustrial sector involves a wide range of government interventions or initiatives at the macroeconomic, sectoral, industry and institutional levels.

The Framework

"Diamond of national advantage." In examining the growth of global industries, Porter (1990), in his now famous book on the competitive advantage of nations, presents what he calls the "diamond of national advantage" that determines why a nation would achieve international success in a particular industry. The diamond consists of four broad interacting and mutually reinforcing attributes of a country that provide the home environment for promoting or impeding the creation of competitive advantage internationally of domestic firms. They are:

▲ factor conditions – the quantity and quality of various factors of production necessary to compete internationally in a given industry, e.g., skilled labor, infrastructure, etc.;

▲ demand conditions – nature of demand in the home country for the industry's product or service;

▲ related and supporting industries – presence or absence in the country of internationally competitive supplier and related industries;

▲ firm strategy, structure and rivalry – the conditions in the nation governing how companies are created, organized, and managed and the nature of domestic competition.

As Porter points out: "the determinants, individually and as a system, create the context in which a nation's firms are born and compete: the availability of resources and skills necessary for competitive advantage in an industry; the information that shapes what opportunities are perceived and the directions in which resources and skills are deployed; the goals of the owners, managers, and employees that are involved in or carry out competition; and most importantly, the pressures on firms to invest and innovate" (p. 71).

Porter's "diamond," while most insightful, is however relevant primarily to developed countries and competition among global industry leaders. In this context, understanding and meeting the changing nature of domestic demand is an important source of business success and eventual international competitiveness, as elaborated earlier in the product cycle literature in the 1960s and 1970s. Additionally, gaining competitive advantage through new technologies and new products is keenest among developed country firms in as much as the developed countries have comparatively better R&D facilities, stronger capital goods industries and highly skilled manpower which together determine capability in technological and product developments.

In contrast, for the Philippines, the most important challenges are gaining comparative advantage and international competitiveness through improvement in the quality of, and more efficient and effective deployment of, its factors of production as well as through the reduction of the technological gap of the country vis-a-vis the rest of the world, i.e., primarily its competitor countries.

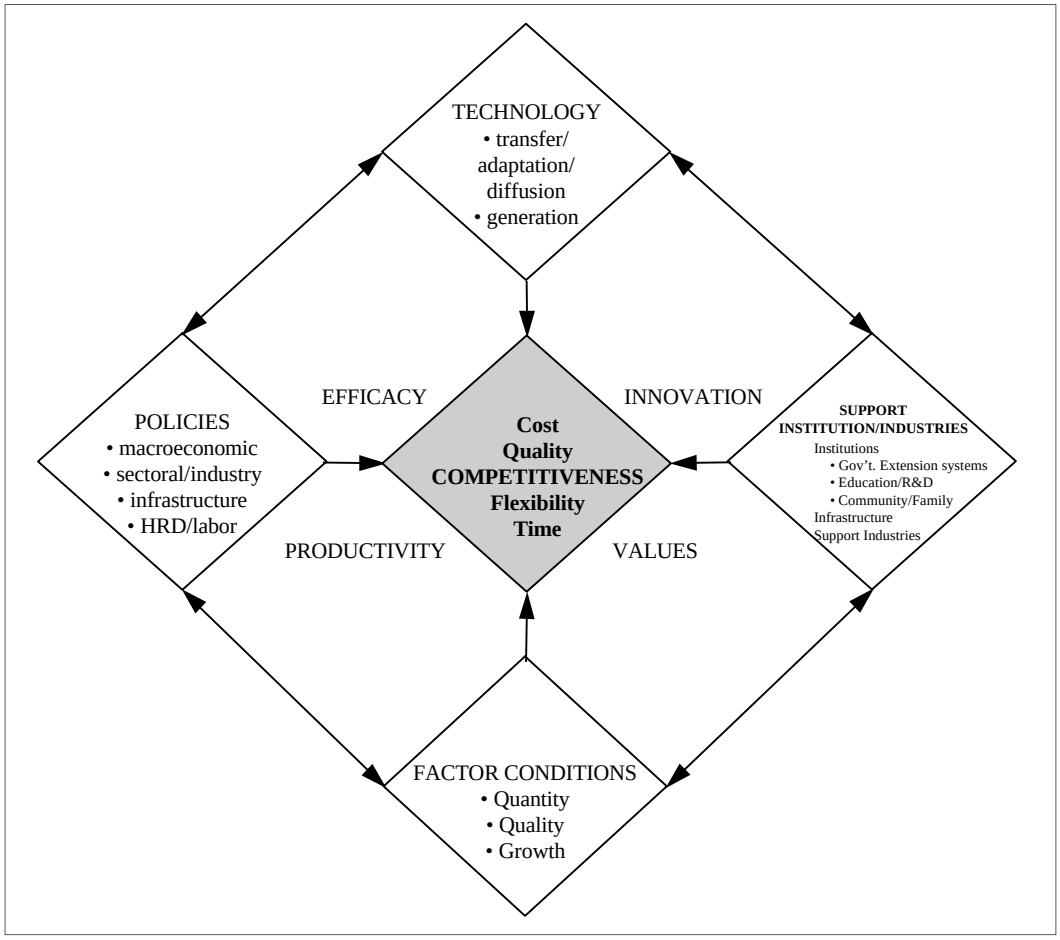
"Diamonds of international competitiveness." Figure 1 presents an alternative framework for the Philippines called "diamonds of international competitiveness." The figure consists of an "inner diamond" and an "outer diamond." The "inner diamond" consists of the foundations of international competitiveness; i.e., productivity, efficacy, innovation, and values. The "outer diamond" presents the key determinants of international competitiveness; i.e., factor conditions, technology, policies, and support institutions/industries.

As mentioned earlier, at the heart of international competitiveness is the productivity with which the country's resources are deployed. It is only through a rate of productivity increase at home higher than abroad that a country improves its international competitiveness and, at the same time, ensures a rising standard of living for its citizenry. Productivity involves the efficient allocation of resources among industries and the so-called "X-efficiency" which involves the efficient and effective management and utilization of resources within firms and/or industries.

Efficacy relates to the efficiency and effectiveness of the implementation of government policies and support institutions, whether government or the private sector. The essence of efficacy is low transaction cost of doing business. Reducing the cost of doing business involves substantial improvement in the country's infrastructure, streamlining of government procedures, more responsive government bureaucracy, and greater congruence among government policies for greater clarity of interpretation and firmer implementation.

Although not usually highlighted, values play an important role in a country's international competitiveness. The people's drive for education, openness to science and technology, work ethic, outward or inward orientation vis-a-vis the rest of the world, and saving versus consumption, among others help shape the social context of production and competition. In the end, the drive

Figure 1
"Diamonds of Competitiveness": An Alternative Framework for Restructuring and International Competitiveness of the Philippine Economy



for improved international competitiveness of the country rests in many respects on the attitudes, aptitudes and support of the populace and not only on systems, infrastructure and the government.

The "outer diamond" consists of the following:

▲ factor conditions – quantity, quality and growth;

▲ technology – the rate and nature of technology transfer, adaptation and diffusion and technology generation;

▲ policies – both macroeconomic, factor market and sectoral policies;

▲ support systems – support institutions and mechanisms; supporting and related industries; and infrastructure.

Factor conditions and technology are directly linked to the production process while policies and support systems provide the overall environment affecting production. Factor conditions include the quantity, skills and cost of the country's human resources, the abundance, quality, accessibility and cost of the country's natural resources as well as the country's size and geography vis-a-vis major export markets, and the amount and cost of capital avail-

able to finance industry (Porter 1990, pp.74-75). Technology includes the country's stock of scientific and technical knowledge that reside in both the govern-ment and private institutions and business enterprises as well as what is embodied in the physical capital of the country.

The international competitiveness of the country is significantly shaped by its factor conditions relative to its competitor countries. The standard theory in international trade emphasizes that the country's comparative advantage at a point in time lies in the goods (and services) that make intensive use of the country's relatively abundant factor of production (and conversely, a much more efficient use of its relatively scarce factor of production).

Innovation, whether process or product and whether embodied in goods like capital equipment or disembodied in institutions and people, is determined by technology transfer from abroad and its adaptation at home, the factor advantages or disadvantages, and the policies and institutions that govern production and technology generation and adaptation. For the Philippines whose labor resources are comparatively more expensive than countries like Indonesia, China, Vietnam and much of South Asia, one source of international competitiveness in labor intensive consumer products is product design and product innovation, an aspect which has sometimes been presented in popular media in terms of a "Milan of Asia" image.

Policies and support systems have significant impact on the pricing and productivity of factors of production as well as on the rate and nature of technology transfer, adaptation and diffusion in the country. Policies and support systems have important roles to play in the drive to improve the quality of factors of production and reduce the cost of doing business in the country.

The policies that influence the country's international competitiveness are numerous and wide ranging. Of special interest are macroeconomic policies, investment and trade policies and fiscal incentives, industrial relations policies, human resource development policies, agricultural policies, and competition policies. Support systems include government and private (or joint government-private) institutions involved in technological, product, marketing, financial and other extension systems and services in production and trading. Infrastructure can be considered part of the support system affecting the profitability of domestic production. Similarly, supporting and related industries can be considered part of the support system which help determine the flexibility and responsiveness of the country's firms to the changes in the world markets. A congruence of policies and support systems will help improve the efficacy of government provision of services and thereby reduce the cost of doing business in the country.

The Challenge: Two Paths to Greater International Competitiveness

Given the loss in international competitiveness of the Philippines during the past decade, *the challenge is in how to regain it and further improve the country's competitiveness*. The "diamonds" highlight two main paths for improving the country's international competitiveness, i.e.,

▲ addressing the "price-cost" gap between the Philippines and its competitor countries, and

▲ reducing the "technology gap" between the country and the rest of the world.

The "price-cost gap" is affected by the product and factor costs (in foreign currency terms) of the Philippines relative to its competitors and by the efficiency and productivity of its factors of production. The "technology gap" highlights the fact that Philippine industrial capital has become comparatively technologically backward compared to its competitor countries because of the much lower investment rate in the country relative to its competitor countries for more than a decade.

Addressing the "price-cost gap" requires the improvement of the overall product and factor pricing environment both at the macroeconomic and sectoral level, improvement of the allocation of resources both between and within industries, and strengthening of the support institutions and the efficacy in the provision of support services to reduce the cost of doing business. Reducing the "technological gap" rests primarily on raising the investment rate in order to upgrade the country's existing capital stock and on strengthening the country's R&D institutions and firms in adopting, adapting, and diffusing technologies.

References

Intal, P. "A Strategic Industrial and Trade Policy" in the *Manila Chronicle* (Reprinted in *Economic Notes* 195, pp. 125-32), November 1987.

Ostry, S. "Lessons from the Triad," in I. ul Haque (ed.) *International Competitiveness: Interaction of the Public and Private Sectors*. Washington, D.C.: The World Bank, 1991.

Porter, M. *The Competitive Advantage of Nations*. New York: The Free Press, 1990.

Sachs, J. "Keep Baby in the Bath Water." *World Link*, September-October 1995.

For further information, please contact

The Research Information Staff
Philippine Institute for Development Studies
NEDA sa Makati Building, 106 Amorsolo Street
Legaspi Village, Makati City
Telephone Nos. 8924059 and 8935705;
Fax Numbers 8939589 and 8161091
E-mail: pintal@pidsnet.pids.gov.ph
and jliguton@pidsnet.pids.gov.ph